EXPORT-IMPORT BANK OF THE UNITED STATES

FILM PRODUCTION GUARANTEES

WHY WE SUPPORT INDEPENDENT FILM PRODUCTION

Our Film Production Guarantee Program is designed to support the financing of independent film[i] production -- a natural fit between our capabilities (assuming the credit risk of foreign buyers) and our mission (supporting U.S. jobs through exports.)

- **Our Capabilities**: Independent film production lending relies primarily on foreign (and occasionally, U.S.) distribution contracts, executed prior to, or during, the production period, as the sole source of repayment. We typically assume foreign credit risk related to export sales through insurance and guarantees. Our Film Production Guarantee assumes a portion of the payment risks associated with distribution contracts, thus encouraging the lender financing of independent films.

- **Our Mission:** By supporting more independent film production, our Film Production Guarantees support the entertainment jobs maintained and created by the independent film sector:

    - According to one report[ii], the independent film industry directly creates or maintains about 150,000 U.S. jobs annually with a combined payroll of $2.5 billion. Furthermore, according to a survey conducted by KPMG Peat Marwick, AFMA[iii] member companies generated over $2.3 billion in foreign sales in 1998.

    - The Film Production Guarantee Program also provides limited benefits in countering foreign government economic incentives designed to lure U.S. film production abroad (“runaway production”.) Our guarantee is only available if at least half of the costs of production relate to U.S. content[iv]. In some cases, taking advantage of foreign incentives might mean that the film would not meet our U.S. content requirements. In such cases, the producer would need to weigh the advantages of our Guarantee against the advantages of the foreign incentives.

OVERVIEW OF INDEPENDENT FILM PRODUCTION LENDING

Unlike the production of major studio films, independent film production relies heavily on bank financing. This may be supplemented by equity contributed by investors and by foreign government economic incentives. Bank production loans rely primarily on payment of foreign distribution contracts concluded prior to the loan due date for their repayment. These distribution contracts give distributors the right to exploit the film (in various media) in their geographic territory for a fixed period of time. Such contracts stipulate a *minimum guaranteed amount* that the distributor agrees to pay *unconditionally* for the distribution rights. While there may be a down payment, most of the amount becomes due when the film negative is made available to the distributor, usually by delivery to a bonded laboratory in its country.

Producers use sales agents to obtain these distribution contracts, and then assign the contracts to the lender as collateral for repayment of the production loan. When the lender's determination of the collateral value of contracts already concluded is sufficient, the lender may commit to finance the film. In determining the collateral value, many lenders value contracts with distributors in developed countries at (or near) the *minimum guaranteed amounts* (less any down payments), while valuing contracts with distributors in developing countries at deep discounts to their *minimum guaranteed amounts*, or granting them no collateral value at all.

In many cases, the amount of the loan required (including reserves for interest accruals) will be greater than the collateral value of existing contracts. Despite this collateral "gap", lenders will often commit to the loan based on a sufficiently high estimate of *minimum guaranteed amounts* related to expected contract sales of unsold geographic territories. (Foreign sales agents are instrumental in providing these estimates.) Lenders charge an additional "gap finance fee" (e.g., 10% flat on the amount of the "gap") for assuming the risk that additional contracts may not materialize or cumulate to an amount necessary to close the collateral gap. Once the film is completed and delivered, the distributors are obligated to pay the balances due on their contracts. As a result of assignment of these contracts, payments will be made directly to the lender to repay the loan.

The three major risks involved in this specialized form of lending are:

- **Performance risk**: The risk that the film will not be completed on time or within budget and delivered to the distributors is usually assumed by a special entity known as a *completion guarantor*, which provides a completion guarantee for a fee based on the loan amount. The completion guarantor approves the budget, handles disbursements, and in case of potential delays or overruns, has the option of terminating production and paying off the loan, or paying the additional costs (including interest for completion delays) out-of-pocket.

- **Marketing risk:** The risk that the gap will not be filled prior to the loan due date by concluding contracts of sufficient value on the unsold territories is usually borne by the lender. The lender may lay off some of this risk by purchasing specialized insurance, if available, although we require the lender to retain at least one-half of this risk for its own account (Minimum Lender Retention) in order to maintain prudent lending practices.

- **Credit risk:** The risks that distributors will not pay the balances on their contracts once the film is made available to them due to commercial causes (e.g., bankruptcy or liquidity problems) or political events (e.g., inability to obtain U.S. dollars for payment) are risks that we are assume under our Film Production Guarantee.

COMPARISON OF OUR WORKING CAPITAL & FILM PRODUCTION GUARANTEES

Although both our Working Capital Loan Guarantee Program and our Film Production Guarantee Program support pre-export financing, the types of lending are different, and so are our guarantees:

- **Underwriting Differences**: Export working capital loans are usually repaid from the borrower's operating cash flows, including the collection of foreign accounts receivable, but can be also repaid from other balance-sheet related cash flows, such as the sale of assets or other sources of external finance. In contrast, repayment of film production loans, usually comes solely from amounts due under international distribution contracts once the film has been delivered (the borrower has no operating cash flows or other assets to which the lender can look for repayment.) Hence, underwriting for the two Programs is quite different:

    - Working capital guarantees are underwritten with a focus on the borrower's financial statements and general credit-worthiness as well as the quality of the collateral. Underwriting is performed up-front, prior to approval of the guarantee.

    - Film production guarantees are underwritten by focusing solely on the quality of the collateral (distribution contracts). Underwriting is approved up-front and periodically thereafter as new distribution contracts are executed.

- **Collateral Differences:**

    - <u>Unearned Receivables.</u> Receivables under film distribution contracts are different than typical working capital accounts receivable in that the bulk of the receivable amounts are not earned until the film negative is delivered, usually to a bonded laboratory in the country of the distributor.

    - <u>No Credit Extended.</u> Generally, export sales financed under working capital loans involve credit terms, whereas the usual terms under film distribution contracts are cash against delivery of the film negative.

    - <u>Limited Performance Risk.</u> Working capital lending usually involves a degree of exporter performance risk, whereas in film financing, the completion and delivery of the film to the distributors is guaranteed by a completion guarantor.

- Single Loan for Export & Domestic Sales. Under our Working Capital Program, lenders typically supplement the loan for which we are providing our guarantee, and which is secured by export-related collateral, with a second working capital loan, secured by collateral related to domestic sales. Each loan has a first priority lien on its primary collateral and is cross-collateralized with the other through a second priority lien on the non-primary collateral.

  In contrast, only a single loan structure is workable for film production lending, with security provided by a first priority lien on all distribution contracts – including any domestic contract,[v] should there be one.

- **Borrowing Bases v. Collateral Base**

  - Under our Working Capital Guarantee Program, we use a borrowing base that lists eligible collateral and their associated discount factors (advance rates) to control disbursements. The amount outstanding under the loan should not exceed the borrowing base amount – if it does, the borrower must repay an amount equal to the excess.

  - Under our Film Production Guarantee Program, we use a "Coverage Base" that lists eligible collateral and their associated discount factors (Applicable Percentages). Rather than limiting disbursements, the Coverage Base determines our maximum liability under the Guarantee. [Once the lender commits to finance production of a film, there is no sense in trying to tie disbursements to the amount of the collateral: unless the film is completed, the collateral will have no value – the distributors have no obligation to pay unless and until the film is delivered.]

- **Differences in Loss Sharing and Lender Risk Retention**:

  - Under our Working Capital Loan Guarantee Program, we cover 90% of the outstanding loan balance and the lender must remain at risk for the remaining 10% [However, under the Delegated Authority Program, we allow lenders to separately collateralize the 10% retention.]

  - Under our Film Production Guarantee Program, both the amount that we guarantee and the amount of risk that the lender must retain for its own account (Minimum Lender Retention) depend upon both *our* valuation of the collateral (Coverage Base Amount) and the amount outstanding under the loan:

    - If the Coverage Base Amount[vi] is equal to our greater than 90% of the principal amount outstanding (i.e., the outstanding amount is at least 90% supported by the collateral), the guaranteed amount is

90% of the outstanding loan balance. The lender is required to remain at risk for the remaining 10%.

  - If the Coverage Base Amount is less than 90% of the principal amount outstanding, the guaranteed amount is the Coverage Base Amount – we do not cover the "gap" between our discounted valuation of the collateral (Collateral Base Amount) and the amount outstanding. In this case the Minimum Lender Retention is equal to one-half of the excess of the outstanding loan balance over the Coverage Base Amount (i.e., one-half of the collateral "gap"). In other words, we do not want more than one-half of the gap amount laid-off with third parties in order to ensure lender discipline.

- **Miscellaneous Differences**:

  - **Eligible Lenders**: Participation in the Film Production Guarantee Program is limited to those lenders that can demonstrate substantial experience in film production lending, using foreign distribution contracts as collateral.

  - **U.S. Content:** While both Programs require 50% U.S. content, this concept is defined somewhat differently under each Program.

  - **Shipping from the U.S**.: While exports supported under the Working Capital Loan Guarantee Program must be shipped from the U.S., the Film Production Guarantee Program places no restrictions on where filming (production) occurs.

  - **Capitalized Interest**: Since borrowers under the Film Production Guarantee Program have no operating cash flow to rely upon, interest accrued up to the due date is capitalized and financed from interest reserves included in the loan commitment amount.

BENEFITS FOR PRODUCERS

- **Improved Access to Lender Finance:** Through our Film Production Guarantee, we assume a portion of the credit risks relating to your distribution contracts, thereby encouraging lenders to:
  - Finance films that they might otherwise refrain from financing due to concerns about receiving payment from overseas distributors or concerns about their exposure with certain distributors or geographic areas;
  - Commit to finance films sooner, rather than waiting for additional distribution contracts to be executed; and
  - Increase overall lending to the independent film sector, since the U.S. Government is effectively guaranteeing a portion of their exposure to international distributors.
- **Affordability:** We charge a flat 0.5% fee on the amount of the loan commitment. To the extent that our Guarantee effectively enhances the overall value of the initial basket of distribution contracts at the time of loan commitment, the Guarantee may save you money in "gap" financing fees. If the amount of the "gap" is reduced by only ½ of 1% of the total loan amount as a result of enhancement, the Guarantee can essential pay for itself.

HOW PRODUCERS CAN UTILIZE OUR PROGRAM

Independent film producers should contact an experienced film production lender. Only lenders can apply for a guarantee and they must first enter into a Master Guarantee Agreement with us. Many members of AFMA's (WWW.AFMA.COM) Affiliated Financial Institutions may have the requisite experience to participate in this Program. So far, we have concluded (or are in the process of concluding) Master Guarantee Agreements with the following lenders:

The Lewis Horwitz Organization, a division of Southern Pacific Bank
1840 Century Park East, Ste. 1000
Los Angeles, CA 90067-2101
Phone: (310) 275-7171 Fax: (310) 275-8055

Comerica Entertainment Industries (Comerica Bank – California)
9920 S. La Cienega Blvd., Ste. 1010
Inglewood, CA 90301
Phone: (310) 417-5449 Fax: (310) 417-5644

BENEFITS FOR LENDERS

- **Protect Yourself Against Credit Risk:** Our Film Production Guarantee effectively protects you against defaults by foreign (and U.S.) distributors, whether the cause of the default is due to commercial reasons (such as bankruptcy and liquidity problems) or political events (including inability of a foreign distributor to legally obtain U.S. dollars to make payment). Our Guarantee effectively covers up to 90% of nonpayment risk, depending upon our risk classification of the distributor[vii].

- **Exceed Exposure Limits, Leverage Your Capital:** Our Guarantee is backed by the full faith and credit of the U.S. Government. To the extent that we effectively assume a portion of the repayment risk on distribution contracts securing your loan, you are replacing distributor risk with U.S. Government risk. This may allow you to exceed (internal or external) exposure limits with respect to particular distributors, countries or geographic areas.

- **Reduce the "Gap" Element in Your Loans:** To the extent our Guarantee enhances the valuation of collateral backing your loan, you may be able to increase your valuation of the collateral, thereby reducing the need for "gap" finance. [Gap usually refers to the shortfall in collateral value as compared to the loan commitment amount.] In particular, we effectively cover 58.5% of the credit risks of our *secondary* distributor risk class. If you normally (without our Guarantee) value receivables from such distributors at a lesser amount, our Guarantee should enhance the value of this class of collateral. For illustration, we provide an example[viii] of the benefits of collateral enhancement.

- **Letters-of-Credit:** In addition to straight production financing, our Guarantee documentation also allows for acquisition financing via letters-of-credit.

- **No Minimum or Maximum Loan Amount**: We place no minimum or maximum on the amounts of the loans we guarantee, although loans in excess of $10 million will take longer to process and will come under greater scrutiny as to why U.S. Government support is needed.

- **No Limit on Overseas Filming:** We do not restrict where filming takes place, but require that at least half of the budgeted expenditures of production qualify as U.S. content[ix].

- **Flexible Payment Terms:** Our Guarantees provide lenders with the flexibility to extend the loan's due date up to a maximum of 240 days without our prior approval, but charge an additional fee for such extensions.

- **No Restrictions on Use of Foreign Government Incentives:** So long as the film meets our U.S. content requirements, we have no restrictions on taking advantage of foreign government financial incentives, such as production credits and tax incentives.

- **No Restriction on Gap Financing:** We place no restrictions on the use of "gap" financing, by which we mean the practice of making a loan commitment where the full commitment amount is greater than the value of the initial collateral. Our Guarantee coverage is limited to that portion of any loss that is fully supported by our valuation of the collateral (i.e., the guaranteed amount is the lesser of 90% of the outstanding loan balance or the Coverage Base Amount). Our requirement of Minimum Lender Retention, however, is designed to limit the imprudent use of "gap" financing.

- **Affordability:** We charge a flat 0.5% of the amount of your loan commitment, regardless of term. To the extent that our Guarantee allows you to increase your valuation of the collateral, thereby decreasing any "gap" amount, your borrower may be able to save on fees[x] related to "gap" finance.

- **Quick Turnaround:** We anticipate a fairly rapid turnaround on requests for Guarantees on individual film production loans.

- **Flexible U.S. Content Definition:** In order to qualify as U.S. content for meeting our 50% minimum requirement, expenditures for personal services, such as acting, set building, filming, directing, *must* be performed by U.S. citizens or permanent legal residents. However, expenditures certain "key talent" that does not meet the U.S. citizen/resident requirement may still qualify as U.S. content, provided that the amounts are subject to U.S. federal income tax.

KEY FEATURES

- **Eligible Lenders:** Guaranteed lenders:
  - Must be financially viable and able to perform;
  - Must have substantial experience in lending secured primarily by international distribution contracts for the purpose of film and/or television programming production. Experience of management obtained at lenders other than the applicant can count towards this requirement;
  - Should have a distinct division or business unit set up primarily for the financing of film and/or television programming production; and
  - Can be U.S. or foreign, but must have at least a U.S. presence.

  We evaluate lenders' eligibility on the basis of information submitted in the *Lender Profile*.

- **Eligible Films:** Films must be:
  - **Feature-length theatrical motion pictures** (i.e., episodic television programs or non-feature length motion pictures do not qualify) intended for exploitation worldwide through various motion picture distributors.
  - **Independent in nature**, which means:
    - Not produced by a Major Studio[xi];
    - For which less than 50% of the Production Budget is being furnished or guaranteed, directly or indirectly, by a Major Studio;
    - For which less than 50% of the aggregate receivables are due from Major Studios (so long as the 50% limit is not violated, the borrower can enter into contracts with Major Studios or distributors owned or controlled by Major Studios);
  - **Meet our U.S. Content Requirements**: At least 50% of the budgeted production expenditures should qualify as U.S. content[xii]. There is no restriction on the geographic (U.S. or overseas) location of film production or the duration of film production in any particular site. The borrower must fill out a *U.S. Content Certificate.* Provided that the film meets our U.S. content requirements, there are no restrictions limiting the borrower from taking advantage of foreign government incentives, such as production credits and tax incentives.

- **Export-Oriented**: At least 50% of the value of the film receivables are derived from the licensing and distribution of the film in territories outside the United States;

- **Eligible Borrowers** are single purpose, bankruptcy-remote entities organized to produce a single film.

- **Type of Financing:** We will consider both:

    - Direct disbursements loans involving a completion guarantee; and

    - Film acquisition loans where the lender issues a letter-of-credit on behalf of the borrower for the benefit of a licensor or supplier of the borrower.

- **Coverage Base Schedule/Coverage Base Amount:** The Coverage Base Schedule (Annex A to the Loan Authorization Agreement) is a document that lists all of the film's distribution contracts, the "eligible" receivable amount of each contract and the discount factor (Applicable Percentages) that we have agreed to apply in calculating the Coverage Base Amount.

    - **Eligible Receivables** arise from distribution contracts:

        - That are payable in the U. S. in U.S. Dollars;

        - In which the lender has a perfected first priority lien; and

        - For which the payment that is due (or which will become due) is not subject to any condition except delivery of the film and/or passage of time, less all taxes and any allowances, credits and offsets required, allowed or permitted to be deducted.

      Receivables that do not meet the above qualifications are "ineligible" and not used in determining the Coverage Base Amount (see next section)

      Receivables that will become due after the distributor picks-up the negative, will generally be excluded from the Coverage Base Amount (i.e., be assigned a "zero" Applicable Percentage).

    - **Applicable Percentages** are the discount factors applied to the Eligible Receivables of any distribution contract. The Applicable Percentage represents the maximum percentage of default coverage we are indirectly providing through our Guarantee. In general we determine the Applicable Percentage for receivables for a particular distributor when executing the Coverage Base Schedule:

   - *Primary* distributors generally are those in low-risk countries. The Applicable Percentage for contracts of primary distributors is 90% (i.e., 10% discount). We use the best risk grade in an international country risk classification maintained by the Organization of Economic Cooperation and Development (OECD). While a distributor in a low-risk country may be given primary status, evidence of adverse credit information may demote the distributor's status to secondary (or even tertiary.)

   - *Tertiary* distributors are generally those in high-risk countries. The Applicable Percentage for contracts with tertiary distributors is 0% (i.e., 100% discount). We define high-risk according to our Country Limitation Schedule which is available on our web site (www.exim.gov) as those where we do not allow "discretionary credit limits" (a form of delegated authority) to exporters under our normal short-term export credit insurance program. However, it is possible for a distributor in a high-risk country to be promoted to secondary status, given the existence of sufficient positive credit information.

   - *Secondary* distributors are generally those in countries that are not low risk or high risk as defined above, and where we have at least some positive credit information. The Applicable Percentage for contracts with secondary distributors is 65% (i.e., 35% discount). In the absence of any credit information (or existence of adverse credit information) about the distributor, we will lower the status of that distributor to secondary. However, if there is very significant positive credit information about a distributor in a "secondary country" we may treat the distributor as primary

   - *U*.S. Distributors. We will not provide indirect (or direct) coverage of contracts with U.S.-based distributors since these are domestic sales, not exports. While any contracts with U.S. distributors will be listed on the Coverage Base Schedule, they will be assigned a "zero" Applicable Percentage.

- **Modified Coverage Base Schedules:** From time-to-time the Coverage Base Schedule is updated to add new contracts that have been executed with respect to a film and/or to show changes in the receivable amounts.

- **Coverage Base Amount:** Whereas in traditional asset-based lending, the lender uses a borrowing base to control disbursements and ensure that the outstanding loan balance is fully supported by the collateral, the Collateral Base Schedule serves neither of these purposes. On the contrary, the primary purpose of the Collateral Base Schedule is to calculate the Collateral Base Amount, which helps determine our principal liability under the Guarantee. This amount is simply the discounted value of the Eligible Receivable Amounts using the relevant Applicable Percentages. The Collateral Base Amount (and our Guarantee liability) grows as new contracts are executed and added to (new versions of) the Collateral Base Schedule.

- **Amount Guaranteed:** The principal amount we pay in case of claim will usually be the Coverage Base Amount, unless the loan is well collateralized and the Coverage Base Amount is greater than 90% of the amount of principal in default, in which case the guaranteed amount is 90% of the principal in default. Our interest liability is the unpaid interest on the principal liability amount calculated at the normal interest rate (excluding any penalty rate) to the date we pay your claim. In general, our principal liability is the lesser of the following:

    - 90% of the loan commitment amount – this puts an absolute limit on our exposure;

    - 90% of the outstanding principal balance on the claim date – i.e., our maximum coverage of a loss is 90%; or

    - Coverage Base Amount – our discounted valuation valuation of the collateral.

- **Gap Financing**: We place no restrictions on the usage of "gap" financing techniques, since our Guarantee does not cover outstanding loan balances in excess of the Coverage Base Amount. For example, if the borrower defaults on a $1 million loan that has a $500,000 outstanding unpaid balance and a Collateral Base Amount at the time of default of $300,000, we would pay a claim of $300,000, plus covered interest, but would not pay any claim related to the $200,000 excess of the outstanding balance over the Coverage Base Amount.

- **Minimum Lender Retention (MLR**) is the amount that we require the lender to remain at-risk with respect to the loan amount outstanding.

    - If 90% of the outstanding loan balance is less than or equal to the Collateral Base Amount (i.e., the amount outstanding is 90% supported by the collateral), the MLR is 10% of the outstanding loan balance.

    - If 90% of the outstanding loan balance exceeds the Collateral Base Amount (i.e., there is insufficient collateral to completely support the amount outstanding), the MLR is:

        - 50% of the excess of the loan balance over the Coverage Base Amount (i.e., one-half of the collateral "gap").

- **Maturity Date Extensions:** You can extend the loan maturity date without our approval, so long as:
    - The total extensions cannot exceed 240 days;
    - You pay the additional Facility Fee; and
    - Extensions exceeding 120 days in the aggregate must be related to delivery date extensions requested by the Completion Guarantor and the Completion Guarantor must be obligated to pay the interest accruing during such extensions.

- **Facility Fee:** Our compensation for providing a Guarantee is 0.5% of the Loan Commitment Amount and is payable up-front. If the loan maturity date is extended or the Commitment Amount is increased, additional Facility Fee is due as follows:
    - Maturity date extension: 0.5% x Commitment Amount x Extension Period (as a fraction of a year)
    - Commitment Amount Increase: 0.5% x Amount of Increase

- **Participations:** You may participate, transfer, assign, or sell your interests in the loan to other lenders provided that you remain responsible for your obligations under the Program, including the filing of claims and remaining at-risk for the Minimum Lender Retention.

- **Amount Limitations:** There are no minimum or maximum sized loan facilities, although requests for Guarantees of loan commitments in excess of $10 million will take longer to process and be subject to greater scrutiny as to the need for U.S. Government support. At this time, there are no aggregate limits on Program activity or individual lender activity under the Program.

- **Claims:** Only the guaranteed lender can file a claim. This must be done no earlier than 30 days after date of default and no later than 120 days after date of default. Claim documentation required includes such items as copies of:
    - Written demand on the borrower and all distributors still owing;
    - All loan documents including all lien perfection filings;
    - Evidence that film was delivered to each distributor still owing;
    - Certification that you have complied with all lender obligations;
    - Executed copies of each contract with a balance owing;
    - Records of disbursements and application of payments;
    - Certification of retention the Minimum Lender Retention.

We may request that you execute an Assignment Agreement to us as a condition of claim payment.   In general, we pay properly-documented claims within 30 days of receipt.

Recoveries: Should there be any recoveries from any source, we receive 90% (and you receive 10%) of recoveries (net of any recovery expenses) until we have fully recovered our claim payment. After being made whole with respect to our claim payment, any excess recoveries revert to the lender.

DOCUMENTS AND PROCEDURES (for lenders)

- **Obtaining Participation in the Film Guarantee Program.** We limit participation in the Program to those lenders that, in our determination, satisfy the following eligibility criteria.
    - Eligibility criteria include:
        - Financial viability and ability to perform;
        - Substantial experience in lending secured primarily by international distribution contracts for the purpose of film and/or television programming production. [Experience of management obtained at lenders other than the applicant can count towards this requirement];
        - A distinct division or business unit set up primarily for the financing of film and/or television programming production; and
    - **Lender Profile (Annex B to the MGA):** The Lender Profile sets forth information with respect to a lender including, among other things: experience, organizational structure, management, lending policies and financial statements. We will use the Lender Profile to determine if a lender is eligible for participation in the Program.
        - If you wish to considered for participation, please send a completed Lender Profile to:

          Charles Goohs, Manager, Product Development
          Export-Import Bank of the United States
          811 Vermont Avenue, NW, Washington, DC 20571
          Tel: (202) 565-3790; Fax: (202) 565-3930.
    - **Master Guarantee Agreement (MGA):** If we approve your organization as a lender under the Program, we will make and enter into the Master Guarantee Agreement with you. The MGA sets forth the general terms and conditions that govern our Guarantee with respect to all your loan facilities under the Program.
        - We will send you two copies of the MGA
        - Sign and return both copies (we will execute them both and return one to you)
        - Submit to us evidence of the authority (including a specimen signatures) as required by Section 2.02 of the MGA.

- **Applying for Guarantees for Specific Loan Facilities:** Once the MGA has been executed, you need to submit the following documents to us with respect to each loan facility:

    - A signed, completed, **Loan Authorization Agreement** (**Annex A** to the MGA) (LAA). The LAA identifies the eligible film and sets forth the specific terms and conditions of a loan facility made by you under the Program;

    - A signed, completed, **Coverage Base Schedule** (**Schedule A** to the LAA) setting forth a complete and accurate schedule for all existing license and distribution agreements in respect of the eligible film. The Coverage Base Schedule is used in determining the amount of our guarantee. We will utilize the financial, credit and other information pertaining to the distributors that you provide (see Schedule C to the LAA below) to assist us in determining the Applicable Percentages[xiii] (discount factors) to apply to Eligible Receivables[xiv] from each distributor;

    - A completed **U.S. Content Certificate (Schedule B** to the LAA**)** signed by the borrower, certifying that at least 50% of the aggregate amount of the production budget (exclusive of the fees, interest and other financing charges of lender) will be comprised of U.S. Content, as defined in the MGA;

    - A copy of your **Loan Presentation and Credit Information (Schedule C** to the LAA) with respect to the loan facility as approved by your credit committee, together with all available financial, credit and other information pertaining to the distributors listed on the Coverage Base Schedule (Schedule A, see above); and

    - **Certifications** with the respective sections completed and signed by the borrower and yourself. This document is necessary for to comply with certain U.S. Government rules and regulations.

- **Approval Process of Individual Loan Facilities:** Upon receipt of the required documentation (Loan Authorization Agreement and Schedules, U.S. Content Certification and Certifications document) we will determine:

    - If the film meets our eligibility criteria:

        - A feature-length theatrical motion picture;

        - Independent[xv] rather than major studio in nature;

        - Export-oriented in nature; and

        - Meets our U.S. content requirements;

    - If there are any issues with respect to:

        - The need for U.S. Government support due to the borrower's access to adequate, alternative sources of production financing (loan facilities of greater than $10 million will receive more thorough scrutiny with respect to this issue)

        - Any other issues, in our sole discretion.

    - Upon satisfactory determinations on these issues, we will consider approval of the Film Production Guarantee and proceed to determine the appropriate Applicable Percentages related to each distributor listed on the Collateral Base Schedule. Determination of Applicable Percentages will be done on the basis of:

        - The risk grade of the country of the distributor; and

        - Credit and financial information we have in our possession, including all information provided by you with Schedule C of the signed Loan Authorization Agreement.

- **Making the Guarantee Effective:** Following approval of Film Production Guarantee:

    - We will execute a final Loan Authorization Agreement, including calculation of the appropriate Facility Fee, together with a completed Coverage Base Schedule (Schedule A to the LAA), including Applicable Percentages for all distribution contracts, and calculation of the Coverage Base Amount. When executed by both parties, this Schedule A shall constitute the initial Coverage Base Schedule in respect of the Loan Facility. If warranted, we will also complete Special Conditions (Schedule D to the LAA).

    - These documents will be forwarded in duplicate. You will need to sign both copies of each document and remit the required Facility Fee as detailed in Section 3.02 of the MGA, as well as fulfilling all other "Conditions Precedent to the Effectiveness of the Guarantee" as spelled out in Section 2.03 of the MGA.

- **Actions Subsequent to Guarantee Effectiveness:**

    - You are required to comply with all required reporting and other obligations as required by the MGA.

    - You may, from time to time, submit a modified Schedule "A" pursuant to Section 2.05 of the Master Guarantee Agreement, together with all available financial, credit and other information pertaining to any new distributors. Any modification of such Schedule "A" shall not be effective unless and until we have approved it and both parties have executed the modified Schedule A, at which time such modified Schedule A will be deemed to constitute the Coverage Base Schedule in respect of the Loan Facility.

NOTES

[i] **Independent Films:** The film industry is divided between recognized major studios and the independent sector. Whereas major studios are multinational, mass marketing, corporate groups, which own their distribution channels around the world, the independent sector consists of individually-financed projects with ownership retained by the producers, who license the film rights to independent distributors throughout the world.

[ii] *The Economic Consequences of Independent Film Making*, Arthur Anderen Economic Consulting, 1999.

[iii] **AFMA** (www.afma.com), formerly known as the American Film Marketing Association, is an association that represents the interests of the independent film sector; the Motion Picture Association of America (MPAA) represents the interests of the major studios. AFMA hosts the American Film Market (AFM) which is the largest motion picture trade event in the world – over $500 million in production and distribution deals are closed annually at the AFM.

[iv] **U.S. Content.** Most film production expenditures relate to personal services, such as acting, producing, directing and filming. To the extent that such services are performed by U.S. citizens or by permanent U.S. residents, they are deemed U.S. content for purposes of meeting the 50% U.S. content eligibility requirement.

[v] **U.S. Distribution contracts:** Independent producers often conclude U.S. distribution contracts, but due to the size and importance of the U.S. market, U.S. distributors often have more clout and will typically wait until film footage is available for viewing or until the film is completed prior to executing a contract. U.S. distribution contracts are therefore generally unavailable to help gain a financing commitment.

[vi] **The Coverage Base Amount** is the sum of the discounted receivables listed on the Coverage Base Schedule. The discounted value of any particular receivable is determined by multiplying the receivable amount by its applicable discount factor (Applicable Percentage) as determined by us in accordance with our classification of the related distributor as “primary”, “secondary” or “tertiary”. The Applicable Percentages are: 90% (primary), 65% (secondary) and 0% (tertiary). Contracts with U.S. distributors (U.S. companies) are not covered and assigned a 0% Applicable Percentage.

[vii] **Credit Risks:** Under our Guarantee coverage, we *effectively* assume distributor credit risk. The amount that we assume with respect to individual distribution contracts depends upon our risk classification of the distributor as:

- “Primary” distributors generally are those in developed countries. In this case we apply a 10% discount and thus provide effective coverage of up to 90%;
- “Secondary” distributors generally are those in developing countries, for which we are in possession of favorable credit information. In this case we apply a 35% discount and thus provide effective coverage of up to 65%; and
- “Tertiary” distributors generally are those in developing countries, for which we have insufficient or adverse credit information. In this case we effectively provide no coverage – i.e., we completely discount the amounts due under contracts with “tertiary” distributors.

[viii] **Guarantee Fee v. Gap Fee Example:**

Loan Commitment:	$4,000,000	
Our Guarantee Fee:	**$ 20,000**	($4,000,000 x 0.5%)
Distribution Contracts:	$3,458,000	

	Face Amount	Lender Valuation	Amt Covered by Guarantee
Primary contracts	$3,000,000	@100% = $3,000,000	@ 90% = $2,700,000
Secondary contracts	$ 308,000	@ 0% = nil	@ 65% = $ 200,000
Tertiary contracts	$ 150,000	@ 0% = nil	@ 0% = nil

Case 1: No Guarantee

Total Collateral Value ($3,000,000 + 0 + 0)	$3,000,000	
Gap Amount ($4,000,000 - $3,000,000)	$1,000,000	
Gap Fee @ 10% (assumed)		**$ 100,000**

Case 2: With Guarantee

Total Collateral Value ($3,000,000* + 200,000)	$3,200,000	
Gap Amount ($4,000,000 - $3,200,000)	$ 800,000	
Gap Fee @ 10% (assumed)		**$ 80,000**

Reduction in Gap Fee ($20,000) completely offsets our Guarantee Fee ($20,000)

Note, the lender valuation of the primary collateral does not fall from $3 million to the effective guaranteed value of $2.7 million as this would make no sense. Coverage of collateral by a guarantee can only enhance the value, not detract from it.

[ix] **U.S. Content.** Most film production expenditures relate to personal services, such as acting, producing, directing and filming. To the extent that such services are performed by U.S. citizens or by permanent U.S. residents, they are deemed U.S. content for purposes of meeting the 50% U.S. content eligibility requirement.

[x] See footnote #8, supra.

[xi] **Major Studio** means a so-called “major” (as such term is commonly understood in the Los Angeles, California motion picture and television industry) producer or distributor of motion pictures and/or television programs or any other Person who directly or indirectly controls, is controlled by, or is under common control with such “major” producer or distributor.

[xii] **U.S. Content** is defined as:

- All budgeted expenditures for the purchase or rental of products, materials, supplies and other goods which are of U.S. origin and manufacture;
- All budgeted expenditures for personal services (such as services of writers, directors, cast, producers, special effects personnel, administrative personnel, animators, cameramen, consultants, attorneys or accountants):
    - To the extent such services are to be performed by an individual who is a U.S. citizen or lawful permanent resident, or
    - In the case of key talent (i.e., lead actor, director, writer, music composer or director of photography) services performed by an individual who is not a U.S. citizen or lawful permanent resident, to the extent such expenditures when paid to such individual are subject to U.S. federal income taxation; and
- All budgeted expenditures for services other than personal services (such as insurance, completion guarantee, transportation and payroll services) payable to a Person (excluding natural persons) legally organized and domiciled in the U.S.

[xiii] **Applicable Percentages** are the discount factors applied to the Eligible Receivables of any distribution contract. In general we determine the Applicable Percentage for receivables for a particular distributor when executing the Coverage Base Schedule. The determination depends upon our judgment of the risk category of the distributor:

- *Primary* distributors generally are those in developed countries and the Applicable Percentage is 90% (i.e., 10% discount);
- *Secondary* distributors generally are those in developing countries, for which we are in possession of favorable credit information and the Applicable Percentage is 65% (i.e., 35% discount); and
- *Tertiary* distributors generally are those in developing countries, for which we have insufficient or adverse credit information and the Applicable Percentage is 0% (i.e., 100% discount).

[xiv] **Eligible Receivables** are receivable arising from distribution contracts:

- That are payable in the U. S. in U.S. Dollars;
- In which the lender has a perfected first priority lien; and
- For which the payment that is due (or which will become due) is not subject to any condition except delivery of the film and/or passage of time, less all taxes and any allowances, credits and offsets required, allowed or permitted to be deducted;

Receivables that don't meet the above qualifications are "ineligible" and not used in determining the Coverage Base Amount. Receivables that will become due after the distributor picks-up the negative, will generally not be used in determining the Coverage Base Amount.

[xv] **Independent Film Criteria:** Our test for an independent film is one that is one:

- Not produced by a Major Studio;
- For which less than 50% of the Production Budget is being furnished or guaranteed, directly or indirectly, by a Major Studio; and
- For which less than 50% of the aggregate receivables are due from Major Studios (so long as the 35% limit is not violated, the borrower can enter into contracts with Major Studios or distributors owned or controlled by Major Studios);

Major Studio means a so-called "major" (as such term is commonly understood in the Los Angeles, California motion picture and television industry) producer or distributor of motion pictures and/or television programs or any other Person who directly or indirectly controls, is controlled by, or is under common control with such "major" producer or distributor**.**